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BEFORE THE
PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2020-263-E

Cherokee County Cogeneration Partners, LLC Complainant, v. Duke Energy Progress, LLC and Duke Energy Carolinas, LLC, Respondents.	)	**CHEROKEE COUNTY COGENERATION PARTNERS, LLC'S POST-HEARING MEMORANDUM OF LAW**

Cherokee County Cogeneration Partners, LLC ("Cherokee") submits this post-hearing Memorandum of Law as directed by the Commissioners and General Counsel of the Public Service Commission of South Carolina (the "Commission"). This proceeding arises under the Commission's implementation of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), including the rules, regulations and precedents of the Federal Energy Regulatory Commission ("FERC") in implementing the requirements of PURPA.

I. ISSUES TO BE DECIDED BY THE COMMISSION

A. Did Cherokee establish a legally enforceable obligation ("LEO") with Duke Energy Carolinas, LLC ("DEC") in September of 2018, therefore entitling Cherokee to DEC's avoided cost rates for energy and capacity?

B. What are DEC's avoided costs, including energy and capacity components, to which Cherokee is entitled pursuant to PURPA?

C. Has DEC negotiated in good faith with Cherokee, as required by PURPA and the orders of this Commission?

II. PRINCIPLES OF PURPA AND FERC PURPA REGULATIONS AND RULES RELEVANT TO THIS PROCEEDING

PURPA was the first ever federal law of its kind, designed to encourage cogeneration and small power production (collectively, "Qualifying Facilities" or "QFs"), by requiring utilities to

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purchase electric power from QFs at rates that are just and reasonable and in the public interest, QFs.[1] As FERC noted, prior to the enactment of PURPA, cogenerators and small power producers faced barriers that Congress sought to eliminate; among them, 1) utilities were not required to purchase the output from these facilities, 2) utilities were not required to do so at fair rates, and 3) utilities could charge discriminatory and unfair charges to back up power and interconnect a facility to the grid.[2] Congress, and FERC through its implementing rules, addressed these obstacles; requiring utilities to purchase the output of the QFs, and adopting rules for interconnection rates and terms.[3]

There are four core features of PURPA that impact this proceeding: 1) the Commission's role in implementing PURPA; 2) the avoided costs to be paid by the utility to the qualified facility; 3) the right of a QF to establish a legally enforceable obligation ("LEO"); and 4) the obligation of the utility and the QF to negotiate in good faith.

1. **The Commission's Role in Implementing PURPA**. First, PURPA is distinct in federal energy regulatory structures and precedents, in that the law is enforced and implemented at both the federal and state levels. FERC established regulations and rules regarding all aspects of rates, terms and conditions for sales of electric power to, and purchases of output from, QFs. Each state establishes rules for implementing PURPA, within the regulatory guardrails adopted by FERC. The states adjudicate disputes (like this one) over the application of the FERC and state PURPA rules, with regard to rates, terms and conditions of service. (*See* Section II, below.)

2. **The Avoided Costs to be Paid by the Utility to the Qualified Facility**. Second,

1 *See* Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978, Order No. 69, FERC Stats. & Regs., 45 Fed. Reg. 12214, 12215 (1980)("Order No. 69").

2 *Id.* at 12215.

3 *Id.*

unlike almost all other ratemaking for electric power production, where rates are based on the *seller's* cost of production, under PURPA, the rate is based on the *buyer's*—the utility's—"avoided cost." "Avoided costs" are the capacity and energy costs the utility avoids by purchasing the QF's output (instead of building a plant, or purchasing power from another utility). Rates for purchases must be "just and reasonable" and in the "public interest" and not discriminate against QFs. The appropriate rate to be paid by either DEC or DEP is at issue in this proceeding (*See* section IV-below).

In determining the appropriate negotiated and contract terms for a large QF like Cherokee, state commissions must take into account certain factors, including the ability of the electric utility to dispatch the QF and the duration of the proposed contract or legal obligation.[4] As Cherokee will demonstrate in detail in its Proposed Order, Cherokee has been providing reliable capacity and energy to DEC for over two decades, and its output has been fully dispatchable by DEC pursuant to the Cherokee/DEC 2012 dispatchable tolling agreement (the "2012 Agreement").

3. **The Right of a QF to Establish a Legally Enforceable Obligation ("LEO").** Third, to ensure that QFs' have a ready market for their output, FERC's regulations permit a QF to "enter into a contract or other legally enforceable obligation to provide energy or capacity over a specified term."[5] As FERC noted, "use of the term 'legally enforceable obligation' is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility." The

4 *See* 18 C.F.R. § 292.304(e)(2)(ii)(A-C).

5 Order No. 69, FERC Stats. & Regs., 45 Fed. Reg. at 12224. Cherokee notes that Duke at various points have attempted to draw a distinction between a "contractual LEO" and "non-contractual LEO." However, it is apparent throughout the implementing rules that there are two types of PURPA commitments: 1) a contract, and 2) a LEO. A LEO would be unnecessary in the event of a contract.

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"legally enforceable obligation" ("LEO") is the QF's--not the utility's--choice, as clearly established under FERC's regulations, and as acknowledged by Duke.[6] Moreover, per the FERC regulations, it is the QF's choice, not the utility's, as to whether to have its avoided costs calculated at the time of delivery or calculated at the time the obligation is incurred.[7]

When FERC issued proposed rules permitting QFs to establish a LEO and base their avoided costs based on rates projected at the time of the LEO, rather than at the time of delivery, some commenters objected, arguing that the avoided cost at the time of delivery could turn out to be less than the rates provided in the contract or under the LEO.[8] Despite those concerns, FERC's rules give the QF the right to establish a LEO and have its avoided cost rates based on projected costs at the time of the LEO, rather than at the time its capacity and energy are delivered.[9] FERC recognized the possibility that avoided costs could decline prior to the time of delivery, but noted that in other circumstances, the contract or LEO rate may be less than the avoided costs at the time of delivery. FERC balanced utility customer interests and QF interests by causing them to share the risk of projecting costs. FERC then clarified that the statutory limitation on ensuring that the utility not pay more than its incremental cost was never intended to "require a minute-by-minute evaluation of costs which would be checked against rates established in long term contracts between qualifying facilities and electric utilities."[10]

Cherokee understands the Commission's concerns about the use of avoided cost rates calculated based on a point in time in the past, particularly in what has been most recently been a declining cost environment. However, as set forth above, FERC has clarified through its

6 *See* Bowman Test. at p. 19-20.
7 *See* 18 C.F.R. § 292.304(d)(2)(i-ii).
8 Order No. 69, FERC Stats. & Regs., 45 Fed. Reg. at 12224.
9 See 18 C.F.R. § 292.304(d).
10 *Id.*

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regulations that avoided cost rates established via a LEO do not violate PURPA's requirement that a utility pay no more than its avoided costs to a qualified facility: "rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery."[11] In addition, as Duke has acknowledged, a utility has no unilateral right to nullify or rescind a LEO.[12] It is the state Commission, not the utility, that determines whether a LEO was established in the first place, consistent with FERC's LEO requirement discussed further below.[13]

The Commission has recognized, in its Act 62 implementation,[14] the balance PURPA strikes between the goal of promoting cogeneration and small power production on the one hand, and risks for consumers on the other:

> Act 62 requires electrical utilities to offer 10-year fixed price power purchase agreements from small power producer QFs at each electrical utility's avoided cost. Therefore, the Commission, being bound by the evidence of record presented in the case, is following the General Assembly's direction to approve 10-year contract terms as reasonably balancing the over-payment risks for consumers of longer term fixed price avoided cost contracts while fully and accurately calculating DEC's and DEP's avoided costs.[15]

The promotion of QFs is achieved in part through LEOs, which enable QFs to facilitate sufficient

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11 18 C.F.R. § 292.(b)(5).

12 *See* Duke Response to Cherokee Discovery Request, no. 2-1. Introduced as a hearing exhibit during the Cross examination of Witness Bowman (Hearing Exhibit number not available at this time). (Cherokee asked "Do DEP and/or DEC contend that a utility has the right to unilaterally revoke or nullify a QF's LEO?" Duke responded "[T]he Companies do not contend that a utility has the right to unilaterally revoke or nullify a QF's LEO. A legally enforceable obligation or LEO can be contractual (in the form of a power purchase agreement or PPA) or non-contractual. See Order No. 2019-881(A) at p. 140; FERC Order No. 872, 172 FERC ¶ 61,041 at n. 92 (2020). The Commission ultimately determines whether a non-contractual LEO has been established based on the QF's conduct and the utility's conduct. See Kendal Bowman Direct Testimony, at 19-21 and Glen Snider Direct Testimony, at 8-10.).

13 *Id.*

14 Act 62's implementation by the Commission must be "consistent with PURPA and the Federal Energy Regulatory Commission's implementing regulations and orders, and nondiscriminatory to small power producers . . . . " S.C. Code Ann. § 58-41-20(A) (Act 62).

15 Amended Order Approving Duke Energy Carolinas, LLC's and Duke Energy Progress LLC's Standard Offer Tariffs, Avoided Cost Methodologies, Form Contract Power Purchase Agreements, and Commitment to Sell Forms, Public Service Commission of South Carolina, Order No. 2019-881(A), P 28 (2020).

investor interest:

> "the Commission [FERC] has long held that its regulations pertaining to legally enforceable obligations "are intended to reconcile the requirement that the rates for purchases equal to the utilities' avoided cost with the need for qualifying facilities to be able to enter into contractual commitments, by necessity, on estimates of future avoided costs" and has explicitly agreed with previous commenters that "stressed the need for certainty with regard to return on investment in new technologies." Given this "need for certainty with regard to return on investment," coupled with Congress' directive that the Commission "encourage" QFs, <u>a legally enforceable obligation should be long enough to allow QFs reasonable opportunities to attract capital from potential investors</u>."[16]

As discussed below in more detail regarding LEO legal/policy requirements (*see* Section III, *infra)*, and in Cherokee's forthcoming Proposed Order, FERC's concern that a utility would take steps to circumvent the requirement that provides capacity credits for QFs under a LEO has occurred in this case. In response to Cherokee's Notice of Commitment to establish a LEO in September 2018, DEC's business development manager Mr. Keen denied that Cherokee's Notice of Commitment to form and supporting documentation was a LEO. He did so before DEC even supplied its avoided cost rates in response to the Cherokee September 2018 LEO.[17] Further, when DEC ultimately supplied its avoided cost rates, Mr. Keen claimed DEC owed Cherokee no capacity payment, at that same time it was offering capacity payments to intermittent solar facilities. While DEC will assert it made subsequent "offers" to Cherokee, none were based on DEC's avoided costs at the time of the September 2018 Cherokee LEO. In fact, Mr. Freund testified at the hearing that after he calculated the initial avoided costs sent to Cherokee in October 2018, he was never asked again to re-look at or otherwise review the rates he calculated at that time.[18] Instead, all subsequent DEC or DEP offers were based on avoided costs at the

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16 *See Windham Solar LLC and Allco Finance Ltd*, 157 FERC ¶ 61,134, P 8 (2016) (emphasis added).

17 See Keen Testimony, Exhibit 2, Attachment 3, page 2 (October 5, 2018 letter from Duke to Cherokee).

18 Cross Examination of Witness Freund, Hearing Transcript at p. 354; Oct. 8, 2018 letter from DEC to Cherokee (Keen testimony, Ex. 2, Att. 3, p. 2).

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time of the offer, not based on projected rates at the time of the LEO in September 2018. Duke's last offer in February 2021 also used current avoided cost rates, which would be rates "at the time of delivery" given that the 2012 Agreement expired at the end of 2021. Duke's tactics thus ignored basing rates on the date of the LEO in Fall 2018, and pushed Cherokee into rates at the time of the offer, thus nullifying Cherokee's right to have its rates determined based on projections at the time of the LEO.

4. **The Obligation of Utilities to Offer and Negotiate in Good Faith**. PURPA requires a utility like DEC to buy all the energy and capacity of a qualifying facility like Cherokee (as they have done for over two decades to date). As a result, the Power Purchase Agreement (or means of purchase and sale) is an arrangement that the utility *has to* negotiate with a QF, as opposed to a typical commercial agreement where the parties *want to* negotiate. Therefore, it is not surprising that at times the utility has a somewhat different view than the qualified facility of what negotiation requires in the PURPA context, and negotiation disputes end up before the Commission.

Indeed, the Commission has observed the "possibility of problems that may exist in the negotiation of long-term contracts" between utilities and qualified facilities.[19] Accordingly, while the Commission "urges voluntary negotiation of long-term contracts" between utilities and qualified facilities, in the very same breath (or sentence) the Commission "points to the complaint procedure available through the Commission as a proper forum to resolve any disagreements" between a utility and a qualified facility.[20] Hence the Commission's historical and ongoing role in hearing disputes between utilities and qualified facilities.

19 Order No. 85-347, p. 20.
20 *Id.* at 21.

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In fact, PURPA's requirement to negotiate—and allegations of a lack of good faith negotiation -- have been addressed in more than one Commission order addressing a PURPA dispute between a utility and a qualifying facility. For example, in Docket No. 80-251-E, the Commission granted "extraordinary interim relief" (via Order No. 85-37) based on unreasonable conduct by a utility (Duke Power) in negotiations with a qualifying facility (Aquenergy Systems, Inc.). The Commission further observed that the need for extraordinary interim relief "indicates that perhaps more emphasis on good faith needs to be placed in the negotiations.[21] Further, the Commission has considered various tools (e.g. assessing costs against an "unreasonable party") "to encourage good faith negotiations between qualifying facilities and electric utilities if complaints are received by the Commission or the Commission Staff indicating a lack of good faith negotiations by either party."[22]

There is no definition of "good faith" found in PURPA. However, Section 58-41-20(F)(1) of Act 62 requires utilities to "offer into fixed price power purchase agreements with small power producers for the purchase of energy and capacity at avoided cost, with *commercially reasonable terms* and a duration of ten years." (emphasis added). The requirement to offer power purchase agreements with "commercially reasonable terms" is therefore an element of good faith negotiation. Similarly, South Carolina law defining the "obligation of good faith" makes clear that parties must also observe "reasonable commercial standards of fair dealing" in their negotiations of power purchase agreement. Section 11-35-30 of the South Carolina Consolidated Procurement Code, entitled "Obligation of good faith," provides the following: "Good faith means honesty in fact in the conduct or transaction concerned and *the*

21 *Id.* at 19.
22 *Id.* at 20.

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observance of reasonable commercial standards of fair dealing." (emphasis added).

In sum, PURPA requires that utilities offer qualified facilities power purchase agreements with "commercially reasonable terms," and observe "reasonable commercial standards of fair dealing" in their negotiations with qualified facilities.

The upshot of these PURPA principles that are relevant to this proceeding is that QFs such as Cherokee have rights under these clear provisions of federal law and FERC implementing regulations, and that state commissions must implement PURPA and apply these legal principles when asked to adjudicate disputes arising under PURPA.

III. CHEROKEE HAS ESTABLISHED A LEO THAT REQUIRED DEC OR DEP TO PAY AVOIDED COSTS PROJECTED AT THE TIME OF THE LEO

As discussed in this Section III, Cherokee clearly formed a LEO consistent with FERC's regulations and rules. In Section IV, Cherokee will address the applicable legal principles relevant to the avoided cost projections at the time of Cherokee's LEO.

As noted above, the QF, regardless of the actions of a utility, may exercise the option to commit itself to sell either all or part of its electric output to a utility through a contract or through a LEO.[23] FERC created the LEO in its regulations implementing PURPA, providing that QFs may provide energy or capacity pursuant to a LEO over specified terms, in the absence of a contract.[24] The rates for purchases may be based, *at the option of the QF*, either 1) on avoided costs calculated at the time of delivery or 2) avoided cost rates projected at the time the obligation is incurred.[25]

The purpose behind FERC's creation of the LEO was in furtherance of the federal

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[23] 18 C.F.R. § 292.304(d).
[24] *Id.*
[25] *Id.*

balance struck between customer and QF interests: the LEO provides protection to QFs by preventing utilities from circumventing their PURPA obligations through delayed signings of a contract to benefit from a lower avoided cost, and splits the risk of over- or under-payment of avoided costs between the utility and the QF.[26] The LEO helps to further PURPA's policy objective of encouraging energy conservation through the development of cogeneration and small power production facilities while balancing the right to just and reasonable rates for customers.[27] As described above, to effectuate Congress's statutory directive to FERC in encouraging the development of QFs, LEOs should "be long enough to allow QFs reasonable opportunities to attract capital from potential investors."[28]

While FERC's regulations do not prescribe a specific test that states can use to determine whether a LEO is established, FERC has clarified that there are certain limitations on the creation of a LEO that are inconsistent with PURPA. For example, FERC has recognized that it is the *QF's* actions to sell to an electric utility commits the electric utility to buy from that QF,[29] and thus LEO requirements may not depend on action from the utility. Accordingly, States may not require a fully executed contract, facilities study, or an interconnection agreement in determining the existence of a LEO.[30] Placing the onus solely on the QF to commit itself to sell electric output to a utility furthers the intent of PURPA by preventing utilities from avoiding their obligations through the use of tactics to achieve a lower avoided cost by procurement of

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26 Order No. 69, FERC Stats. & Regs., 45 Fed. Reg. 12,230; *see Deseret Generation & Transmission Co-operative, Inc.*, 175 FERC ¶ 61,041, P 19 (2021) (citing Cedar Creek, 137 FERC ¶ 61,006, at P 36 (citing *W. Penn Power Co.*, 71 FERC ¶ 61,153 at 61,495) (1995)).

27 *See FERC v. Miss.*, 456 U.S. 742, 746 (1982); *see also Power Resource Group, Inc., v. Public Utility Comm'n of Texas*, 422 F 3d 231, 237 (2005).

28 *See Windham Solar LLC*, 157 FERC ¶ 61,134, P 8 (2016).

29 *See JD Wind 1*, LLC, 129 FERC ¶ 61,148, 61,633 (2009); *See also FLS Energy, Inc.*, 157 FERC ¶ 61211, 61730-31, (2016).

30 *See Cedar Creek* at 61024 (citing Order No. 69, FERC Stats. & Regs. at 12,224 (1980)); *See also FLS Energy, Inc., 157 FERC ¶ 61211, 61730 (2016).*

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power from, or construction of, alternative resources. However, states may give effect to FERC's rules, taking action under PURPA through the issuance of regulations, resolution of disputes, or other action,[31] within these guardrails set up by PURPA and FERC.[32]

South Carolina, in implementing PURPA, made a determination pursuant to state law,[33] that requires a Notice of Commitment (NOC) form to demonstrate the creation of a LEO.[34] The form was adopted in a proceeding applicable to "small power producer" QFs (not cogeneration), but can easily be tailored to fit the characteristics of a cogeneration QF, which Cherokee submitted.

North Carolina is the only other state that uses a NOC form in demonstrating the creation of a LEO,[35] the purpose of which is to provide clarity to QFs and utilities in creating a LEO and limit the number of complaints brought before the state Commission.[36] The North Carolina Utilities Commission employs a three-step LEO test under which the developer of the QF is required to "(1) have self-certified with the FERC as a [Qualifying Facility]; (2) have made a commitment to sell the facility's output to a utility pursuant to PURPA via the use of [the NOC Form;] and (3) have received a [Certificate of Public Convenience and Necessity (CPNC)] for the construction of the facility" in demonstrating the existence of a LEO.[37] In 2019, the North

31 *FERC v. Mississippi*, 456 U.S. 742, 751; *see Policy Statement Regarding the Commission's Enforcement Role Under Section 210 of the Public Utilities Act of 1978*, 23 FERC ¶ 61,304, at 61,643 (1983).

32 *JD Wind 1, LLC*, at 61,632 (2009).

33 *See Appalachian Power Company et al.*, 175 FERC ¶ 61,257, at P 11 (2021) (citing *Va. Elec. & Power Co.*, 151 FERC ¶ 61,038 at P 26; and Qualifying Facility Rates and Requirements; Implementation Issues Under the Public Utility Regulatory Policies Act of 1978, 173 FERC ¶ 61,158, at PP 374-88 (2020).).

34 *See* S.C. Code Ann. § 58-41-20(D); see also *Amended Order Approving Duke Energy Carolinas, LLC's and Duke Energy Progress LLC's Standard Offer Tariffs, Avoided Cost Methodologies, Form Contract Power Purchase Agreements, and Commitment to Sell Forms*, at 140, Docket Nos. 2019-185-E and 2019-186-E (January 2, 2020).

35 *Id.* (stating that the Parties agree "that the Notice of Commitment Form is a novel concept and that only North Carolina has established such a mechanism to create a non-contractual LEO.").

36 *In re Cube Yadkin Generation, LLC v. Duke Energy Progress*, LLC, 269 N.C. App. 1, 9-10 (2019).

37 *Id.* at 3.

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Carolina Court of Appeals examined the three-step LEO test, determining in part that the North Carolina Utilities Commission acted within its authority in creating the NOC requirement as it does not interfere with a QF's right to a LEO.[38]

As North Carolina is the only other jurisdiction to utilize a NOC form designed to eliminate uncertainty as to the creation of a LEO, the Commission should find the three-step LEO test particularly persuasive in determining the existence of a LEO in this case. The employment of the North Carolina LEO test would provide additional clarity to QFs and utilities, and promote judicial efficiency through fewer disputes before the Commission. Specifically, the Commission should find that Cherokee meets all elements of the three-step LEO test. First, Cherokee was self-certified as a QF in docket QF94-160-012 and provided its self-certification form (form no. 556) to Duke along with its LEO materials.[39] Second, Cherokee made a commitment to sell its output to Duke through its submission of NOC forms on September 17, 2018 (for DEC)[40] and December 12, 2018 (for DEP).[41] Third, Cherokee has received a CPNC for construction of its facility from the Commission.[42] In fact, Cherokee has been interconnected with, and selling power to DEC, for over two decades. As such, Cherokee clearly meets the North Carolina Commission's and North Carolina Court of Appeal's standards with respect to substantively identical forms for the same utilities at issue in this case (DEC and DEP).

Additionally, as will be addressed in further detail in the Proposed Order that Cherokee will submit shortly, Duke's argument that Cherokee's actions in submitting LEO forms to both

38 *Id.* 10.

39 Cherokee County Cogen. Partners, LLC, Form 556, Docket No. QF94-160-012 (filed Aug. 3, 2012) (registering Cherokee as a Qualifying Facility).

40 *See* Hanson Direct Test. Exhibit 1.

41 *See* Hanson Direct Test. Exhibit 3.

42 *See* Order Granting Certificate of Environmental Compatibility and Public Convenience and Necessity, Order No. 95-1198, Docket No. 1995-628-E.

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DEC and DEP negates Cherokee's LEO rights is misguided, and Cherokee's actions must be considered in context of the applicable laws at the time of the Order. On September 18, 2018, Order No. 2016-349 was the law of the land with respect to avoided costs in South Carolina. As explained by Witness Strunk, that order implemented a settlement between Duke and South Carolina intervenors in which Duke agreed to adopt the outcome of a North Carolina decision issued on May 12, 2016.[43] That Order plainly stated the process for determining the avoided cost rates applicable to Cherokee: "All rates for QFs above two MW, or otherwise ineligible for the standard tariffs, shall be negotiated under the Public Utility Regulatory Policies Act of 1978 and the Federal Energy Regulatory Commission's implementing regulations."[44] FERC permits QFs to split its output among different offtakers, noting situations arise where a "utility interconnecting a QF does not purchase all of the QF's output and instead transmits the QF power in interstate commerce," including where the "QF sells, plans to sell, or has the express right to sell to any of its output to an entity other than the utility directly interconnected to the QF."[45]

As discussed above, the rights that PURPA has established with respect to QFs, including LEO rights and requirements that facilities characteristics like dispatchability be incorporated into negotiated arrangements, cannot be overridden by the States. PURPA itself does not require that QF arrangements be negotiated; but, where the states contemplate negotiated rates, those rates must reflect dispatchability.[46] It is apparent this Commission understood the same by providing that negotiation of rates take place under PURPA. With this guidance from South Carolina and the protections proffered to QFs under FERC, Cherokee approached DEC with a

43 *See* Strunk Rebuttal Test. at pages 12-13.
44 *Id.*
45 *See Cherokee County Cogeneration Partners, LLC,* 175 FERC ¶ 61,002, at P 17 (2021).
46 See 18 C.F.R. § 292.304(e)(2)(ii)(A-C).

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Notice of Commitment form tailored to its facility and accompanying documents, attempting to check every box under PURPA's LEO precedent and DEC's publicly posted procedures so there would be no question of Cherokee's commitment to put its power to DEC. It further requested that DEC inform Cherokee if DEC believed there was anything further it needed to form a LEO and sought to commence negotiations under the protections that PURPA provides.

When DEC responded on October 8, 2018[47] that Cherokee's Notice did not constitute a LEO, Cherokee continued to follow this Commission's guidance for determining a large QF rate: through continued negotiation. The requirement to negotiate rates carries the underlying requirements that the parties act in good faith and engage *practically* with one another to reach a business solution to a problem. That is exactly what Cherokee did, by corresponding with Mr. Keen (for both DEC and DEP) regarding possible solutions for either DEC *or* DEP that would allow Duke to meet its PURPA obligation without burdening this Commission with litigation or causing Duke legal costs that it would recover from ratepayers. Considering the Commission's directive to negotiate rates, Cherokee's actions with respect to communicating to Mr. Keen that it was indifferent to the offtaker and open to negotiated solutions with either company were not confusing or counter to this Commission's directives under PURPA—in fact, those actions only underscore Cherokee's respect for the applicable law at the time and its intent to commit its power to DEC and DEP in a way that would give Duke flexibility in meeting customer needs. Nothing in the record suggests Cherokee was attempting to make a deal with anyone but Mr. Keen, who acted as the negotiating representative for both companies, because there were no such efforts. It is noteworthy that while Duke argues that Cherokee's submission of a Notice of Commitment to DEP and its response to a DEP RFP undercuts its LEO, those occurred <u>after</u>

47 *See* note 18 *supra*.

DEC's October 8 letter to Cherokee when Duke's business development manager already concluded – incorrectly – that Cherokee's September 2018 Notice of Commitment did not constitute a LEO.[48]

Put simply, Cherokee was negotiating as required by this Commission. Duke was not. As Mr. Snider confirmed, Duke refused to negotiate QF rates with Cherokee, claiming that the negotiations were only with respect to the "terms and conditions" or "T's and C's." Duke's Witnesse Snider confirmed that they did not negotiate rates as required by this Commission; and in fact operated under the assumption that they *could not* negotiate rates with QFs consistent with the settlement that Duke voluntarily agreed to.[49] These witnesses further testified that they did not; and believed they *could not* offer a form of contract that would take Cherokee's dispatchability into account in its offers to avoid discriminating among QFs, which runs directly counter to PURPA's requirements to take dispatchability and contract term into account.[50] It is Duke's misapprehension of its requirements under South Carolina and FERC implementation of PURPA that has created confusion—Cherokee acted reasonably and consistently with FERC's

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48 Duke's obstructive conduct, however, was not limited to communication about negotiated rates. Specifically, Duke had also taken the position during discussions about a potential deal with DEP, that neither Cherokee as a QF nor a firm PPA for purchase of Cherokee's output could be designated as a network resource under the Joint OATT. This is completely inconsistent with FERC precedent, where FERC has found that firm, non-curtailable PPAs can be designated as network resources. See Order no. 890A, where FERC reiterated its conclusion in Order No. 890, that firm, non-curtailable PPAs can be designated as network resources. Order No. 890A, 73 Fed. Reg. at 3084. DEP would thus be able to designate a PPA with Cherokee—which would be non-curtailable—as a network resource, enabling DEP to import power from the DEC zone. Instead, besides not agreeing that such a PPA could be designated as a network resource, Duke also said that Cherokee would have to pay for point to point transmission service in order to transmit the output from Cherokee in DEC to DEP. This would result in a pancaked rate, inconsistent with FERC policy, and Duke's own commitment made to FERC when it sought approval of the DEC/DEP merger. *See* Hanson Direct testimony at pp. 17-18 and Hanson Rebuttal Testimony at p. 14 & Exhibits 2 and 3 (showing a number of QFs and PPAs with QFs designated as network resources under other FERC-regulated utilities).

49 Transcript, vol. 2 (Cross examination of Duke Witness Snider), p. 265 ("..one of the things that LS Power I don't think has ever really understood and probably maybe they still don't understand is that we can't negotiate avoided costs. That is our position."); *see also Id.* at p. 266 ("But negotiations would be something like the terms and conditions in the PPA. Maybe you can change some language in there or modify that. Or the term, maybe you can negotiate the term. So that's what I kind of mean by negotiations.").

50 *See* 18 C.F.R. § 292.304 (e).

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and PURPA's guidance, and followed the applicable Commission guidance at the time to negotiate in good faith.

IV. CHEROKEE'S AVOIDED COST RATES WERE BASED ON DEC'S PROJECTED AVOIDED COSTS AT THE TIME OF THE LEO, CONSISTENT WITH PURPA

As noted above, the avoided cost rates must be just and reasonable, in the public interest and not discriminatory to QFs.[51] In addition, a utility cannot be required to pay more than its avoided costs.[52] Contrary to Duke's assertions, Cherokee has never sought that DEC or DEP pay more than their avoided costs. Duke's assertions are based on a false premise—Duke either unilaterally determined that Cherokee did not submit a LEO in September 2018, or unilaterally rescinded Cherokee's LEO. In either case, as Duke acknowledged in its own response to Cherokee's discovery request, Duke has no legal authority to do either. It is up to the Commission, not Duke, to determine whether a LEO was formed or not and if one was formed, Duke has no unilateral right to rescind a QF's LEO. By doing so, Duke, through all its actions that it took with regard to Cherokee, in effect denied Cherokee's right to determine its avoided costs at the time of its LEO in September 2018, as opposed to basing its avoided cost rates on future avoided cost forecasts or rates at the time of delivery. All the "offers" provided by DEP or DEC after its October 31, 2018 "offer" were based on current avoided cost rates, not based on projected rates at the time of Cherokee's LEO. Mr. Freund confirmed this point, when he testified that after he calculated the rates in their October 31, 2018 rate sheet, he was never asked again to review or recalculate the rates included in a simple rate sheet on October 31, 2018.[53] All his calculations of the avoided cost rates subsequent to that date were based on current forecasts

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51 *See* 18 C.F.R. § 292.304(a).
52 *Id.*
53 *See* Transcript vol. 2 (Freund Cross Examination), p. 354.

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of avoided costs, i.e., rates calculated based on then-current forecasts to apply to years after the Dec. 31, 2020 expiration of the 2012 Agreement. No gas curve detail was provided before the complaint was filed. It was not until discovery in this case that the gas curves were provided.

The October 31, 2018 rate sheet was just that—it contained an on-peak and an off-peak energy rate, but no capacity rate.[54] In addition, despite purchasing Cherokee's output for over 20 years and since October 2012, per a dispatchable tolling agreement, Duke submitted a form "must run" contract, appropriate for intermittent resources such as solar or wind facilities, but certainly not for a fully dispatchable generation plant such as Cherokee's cogeneration plant. Moreover, DEC provided no back up at all to show either (i) how Duke calculated the proposed energy rates, or (ii) why Duke believed it was not obligated to pay Cherokee for capacity, as it had done for the past two decades under PURPA.

Duke's failure to incorporate the fully dispatchable operational feature of the Cherokee plant in its offers violated PURPA and ignored the over two decades of reliable power provided by Cherokee, including service under the 2012 Agreement. As noted above, where an avoided cost rate is not based on a standard offer, the state commission is required to take into account certain factors for purchases, including "ability of the utility to dispatch the qualifying facility, the "expected or demonstrated reliability of the qualifying facility," and certain contractual or LEO terms, including "the duration of the obligation."[55] By offering energy only rates, a "must run" non-dispatchable contract and no capacity payment, Duke violated PURPA by ignoring these attributes of the Cherokee facility that were not just possible features on paper, but actual operational attributes of the Cherokee facility relied upon by Duke. It would not be a symbol of

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54 *See* Strunk Direct Testimony p. 11.

55 *See* 18 C.F.R. § 292.304(e)(2)(ii)(A-C).

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favoritism to offer rates/contract terms different from intermittent wind or solar facilities, but instead application of clear provisions in FERC regulations with regard to attributes of a particular QF that the Commission must take into account in determining an avoided cost rate.

Further, Mr. Strunk's testimony and calculations supporting his avoided cost rates for capacity and energy based on projected rates at the time of the LEO are the only avoided cost rates based on projections at the time of the LEO that are in the record up to and through the hearing. Duke did not, in 2018 or anytime thereafter, up to and including the hearing, submit rates for 2018 based on the use of a dispatchable tolling agreement with capacity payments. Only after the hearing, at request of the Commission, did Duke submit a rate with capacity payment and utilized a dispatchable tolling agreement instead of a must-run agreement.

Consistent with PURPA, Mr. Strunk took into account the dispatchable nature of the Cherokee facility. He realized that DEC's customers would not be well served by a must-take agreement that embeds inefficiencies into DEC's dispatch. (DEC and Cherokee agreed to abandon such a structure in 2001 when they added dispatchability provisions to the initial Cherokee contract.) To reflect Cherokee's dispatchability, and consistent with the existing contract, Mr. Strunk structured the payments on a \$/kW-year basis, consistent with the parties' existing contract and consistent with the PURPA requirement to account for the facility's dispatchability.

Mr. Strunk calculated an appropriate \$/kW-year rate by adding the value of Cherokee's energy and the value of its capacity. To arrive at the energy value, he relied upon DEC's own offer to compensate Cherokee for energy, which relied upon the September 2018 standard QF modeling run that DEC had performed. Witness Strunk simply assumed that the energy rates in DEC's October 31, 2018 offer were consistent with DEC's forecasted avoided energy costs at

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that time, as required by PURPA. Witness Strunk lined up the on-peak and off-peak avoided energy rates with a projection of Cherokee's 2021 output, then calculated the energy value (over and above the cost of dispatching Cherokee) and expressed that as a $/kW-year payment as compensation for DEC's avoided energy costs.

Witness Strunk also included compensation for avoided capacity costs, as the existing rates being offered to QFs at that time incorporated compensation for capacity, and Cherokee had been providing reliable capacity to the DEC system for decades. Witness Strunk sourced the capacity value from DEC's Schedule PP tariff to assure non-discrimination. When Cherokee established a LEO in September of 2018, the Schedule PP tariff was the only capacity rate for QFs that was approved by the Public Service Commission of South Carolina (via Order 2016-349). Because the per unit value of avoided capacity costs does not change with respect to the size of the QF, it was appropriate for Witness Strunk to carry over that avoided capacity cost rate from the small QF tariff to the large QF rate available to Cherokee. Mr. Strunk took dollar per MWh rates in this tariff and applied them to a projection of Cherokee's 2021 MWh output to arrive at the capacity revenues for Cherokee. This approach resulted in a capacity rate that appropriately implements PURPA since it: (1) relies on the most recent commission order at the time Cherokee established its LEO, and (2) provides compensation for Cherokee's reliable capacity that can supplant DEC investment, as intended by PUPRA.

Mr. Strunk's avoided capacity payment methodology corrects DEC's misconception that Cherokee's capacity rate should have been zero at the time of DEC's October 31, 2018 offer letter. Order 2016-349, the law of the land on October 31, 2018, included rates that were based on full capacity compensation payments for QFs, and were not discounted to reflect years without a purported capacity need. Only subsequent to the establishment of Cherokee's LEO,

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after the passage of the Energy Freedom Act[56], did IRPs formally require Commission approval and only in the 2019 avoided cost docket did the Commission confirm the nexus between the IRP and the avoided cost calculations. We note that the IRP approval process has proven to be particularly contentious for DEC in recent years, as evidenced by their ongoing 2020 IRP approval proceeding with this Commission wherein the Commission identified major substantive flaws with Duke's most recent IRPs. The avoided cost review processes undertaken by the Commission are similarly contentious, underscoring the need to rely on values that have been explicitly approved by the Commission in the absence of an alternative diligence process.

V. DUKE'S ACTIONS LACKED GOOD FAITH IN ITS DEALINGS WITH CHEROKEE'S LEO AND PROPOSED AVOIDED COST RATES, AND CHEROKEE ACTED IN GOOD FAITH, IN ATTEMPTING TO WORK OUT A NEW CONTRACT WITH DEC CONSISTENT WITH PURPA

As Cherokee will describe in its Proposed Order, Cherokee actively negotiated with DEC and DEP as required by South Carolina law and the Orders of this Commission. On the other hand, DEC and DEP failed to make offers with "commercially reasonable terms" and failed to observe "reasonable commercial standards of fair dealing" in its interactions with Cherokee. As set forth above, 1) Duke failed to recognize Cherokee's established LEO and its right to avoided costs based on projected rates as of the that LEO; and 2) failed to acknowledge the dispatchability of the Cherokee Facility and other aspects of the parties' long-term relationship. Duke's unwillingness to negotiate in a reasonable commercial manner created the issues that are before this Commission for determination.

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[56] *See* note 14 *supra*.

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VI. CONCLUSION

In light of the above, Cherokee requests that the Commission reach the following conclusions. First, Cherokee established a LEO with Duke as of September 17, 2018. Second, Mr. Strunk established a methodology consistent with PURPA for computing DEC's avoided costs, which includes energy and capacity components at the time of the LEO, to which Cherokee is entitled pursuant to PURPA. Third, Duke lacked good faith in its dealings with Cherokee, and consequently failed to base its avoided costs on projected rates as of the September 2018 LEO.

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Respectfully submitted,

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